PRIVATE SECURITIES LITIGATION/Aiding & Abetting

SUBJECT: **Private Securities Litigation Reform Act of 1995 . . . S. 240. Bryan amendment No. 1474.**

ACTION: AMENDMENT REJECTED, 39-60

SYNOPSIS: As reported with an amendment in the nature of a substitute, S. 240, the Private Securities Litigation Reform Act, will enact changes to current private securities litigation practices in order to discourage unjust suits and to provide better information and protection from fraud for investors.

The Bryan amendment would strike the bill substitute's section on aiding and abetting and would insert alternate provisions. It would provide that the SEC or any private party could bring an action for aiding and abetting against any party that knowingly or recklessly provided substantial assistance to a primary violator in the commission of securities fraud. In securities fraud litigation, an action that alleges that a defendant is guilty of "aiding and abetting" is an allegation that the defendant assisted the primary violator(s) in the fraud, whether knowingly or through the vague "recklessness" standard. These actions, like other securities fraud actions, are typically brought under the catchall fraud provision contained in Section 10(b) of the Securities Exchange Act and the Securities and Exchange Commission (SEC) Rule 10b-5. Congress never expressly provided for private rights of action when it enacted Section 10(b). In 1994, in the *Central Bank of Denver* case, the Supreme Court ruled that no statutory private right of action exists for aiding and abetting. The Court was silent as to whether the SEC has any right to bring allegations of aiding and abetting. Prior to this decision, courts across the country adopted different scienter (degree of knowledge necessary to make one legally liable) standards for bringing allegations of aiding and abetting. Section 108 of the substitute amendment to the bill will permit the SEC to prosecute aiding and abetting if the defendant knowingly provided substantial assistance in the fraud.

Those favoring the amendment contended:

Senators have already discussed in detail the distinction between "knowing" or "intentional" misconduct and "reckless" misconduct and the limits, if any, that should be applied to joint liability. These discussions are effectively moot, though, if this

(See other side)

YEAS (39)

Republicans (4 or 8%)	Democrats (35 or 76%)	
Cohen	Akaka	Harkin
Jeffords	Baucus	Heflin
McCain	Biden	Hollings
Shelby	Boxer	Inouye
	Bradley	Kennedy
	Breaux	Kerrey
	Bryan	Kerry
	Bumpers	Kohl
	Byrd	Lautenberg
	Conrad	Leahy
	Daschle	Levin
	Dorgan	Moynihan
	Feingold	Pryor
	Feinstein	Robb
	Ford	Rockefeller
	Glenn	Sarbanes
	Graham	Simon
		Wellstone

NAYS (60)

Republicans (49 or 92%)		Democrats (11 or 24%)
Abraham	Helms	Bingaman
Ashcroft	Hutchison	Dodd
Bennett	Inhofe	Exon
Brown	Kassebaum	Johnston
Burns	Kempthorne	Lieberman
Campbell	Kyl	Mikulski
Chafee	Lott	Moseley-Braun
Coats	Lugar	Murray
Cochran	Mack	Nunn
Coverdell	McConnell	Pell
Craig	Murkowski	Reid
D'Amato	Nickles	
DeWine	Packwood	
Dole	Pressler	
Domenici	Roth	
Faircloth	Santorum	
Frist	Simpson	
Gorton	Smith	
Gramm	Snowe	
Grams	Specter	
Grassley	Stevens	
Gregg	Thomas	
Hatch	Thompson	
Hatfield	Thurmond	
	Warner	

NOT VOTING (0)

Republicans (0)	Democrats (0)

VOTING PRESENT(1)
Bond

EXPLANATION OF ABSENCE:
1—Official Buisiness
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

particular amendment is rejected. Proportional liability is assigned after guilt has been determined. Before guilt can be determined, actions must first be brought. If those actions are barred by law from being brought, then obviously the question of whether joint and several liability should apply will never be reached. The Supreme Court, in 1994, ruled that no Federal private right of action exists against aiders and abettors in securities fraud cases. Typically, defendants in private rights of action who have been found guilty of reckless conduct have been sued as aiders and abettors. Therefore, unless the Bryan amendment is approved to restore the status quo ante right of private parties to bring actions against aiders and abettors in securities fraud cases, it will be much less common for a defendant to be found guilty of reckless conduct.

According to the bar association of New York City, securities fraud very rarely succeeds without the aid of lawyers, accountants, underwriters, and other professionals, though it is very difficult to prove that involvement. Unless those professionals unwisely sign their names to documents that prove their involvement (and they are usually too cagey to make that mistake), the most that can ordinarily be proven is that they aided and abetted in the fraud by not discovering it in a situation in which any competent professional should have discovered it. We agree with our colleagues that quite a few frivolous suits are filed against aiders and abettors, but we hasten to add that quite a few meritorious suits are also filed. Often, those banks, lawyers, auditors, and others who are charged with aiding and abetting are really guilty of a lot more, but are just more careful at covering their tracks. If we let the Supreme Court decision stand, many of these professionals will escape punishment for their fraudulent actions. The only aiders and abettors who will be punished under the bill substitute amendment are those who have actions brought against them by the SEC for knowing or intentional fraud. This extremely high standard is unjust. The result will be that investors who have been defrauded will not be able to recover their losses.

To put this issue into perspective, we bring our colleagues attention to the effect that this Supreme Court ruling, which is left virtually intact by this bill substitute, would have had on the *Keating* case if it had been in effect at the time. Charles Keating, the primary wrongdoer, was bankrupt in that case, but $262 million was collected from other primary and secondary wrongdoers. Of that amount, $121 million was from aiders and abettors. (Other bill provisions, primarily the provision limiting joint liability for reckless defendants, would have reduced the amount collected even further, down to a negligible $16 million.) Charles Keating stole more than $262 million from investors, and he did not act alone. Unless the Bryan amendment is adopted, aiders and abettors who help future Charles Keatings will be safe from class action lawsuits, and will be able to keep their ill-gotten gains. The Bryan amendment would correct this fundamental unjustness, and therefore merits our support.

Those opposing the amendment contended:

Once again, we have a difference of opinion with our colleagues. Agreeing to a private right of action against "aiders and abettors" will only encourage more abusive litigation. We are pleased with the Supreme Court decision in the *Central Bank of Denver* case, which overturned aiding and abetting case law. That body of law encouraged frivolous pleadings. We are therefore not about to approve the Bryan amendment, which would not only undo the *Central Bank* decision, it would also greatly expand the right to bring frivolous aiding and abetting suits in many jurisdictions.

One of the primary purposes of this bill is to limit frivolous lawsuits. The Supreme Court, in 1994, took a step in that direction in the *Central Bank of Denver* case. The Court ruled that no Federal statutory authority exists for bringing a private securities action alleging aiding and abetting. The Court did not make any ruling as to the advisability of granting such authority, though the majority opinion noted that aiding and abetting suits present "a danger of vexatiousness" that require secondary actors to expend large sums even for pretrial defense and the negotiation of settlements. Before this case, many jurisdictions had read into section 10b of the Securities and Exchange Act the right of private parties to sue for aiding and abetting. Those jurisdictions developed widely varying degrees of scienter--in some jurisdictions, aiding and abetting was actionable only if it was knowing; in others, an allegation of reckless conduct sufficed. Still other jurisdictions developed their own unique modifications.

The problem with allowing aiding and abetting suits is the same problem as is found with the reckless conduct standard--the definition of such suits is nebulous. Suits that are filed on flimsy, tenuous excuses frequently charge that the defendant aided and abetted rather than acted as a primary actor in the alleged fraud. Though it is certainly possible to claim, for instance, that an auditor's "reckless" conduct in a securities scheme made it a primary, albeit minor, actor in that scheme, and though such claims are frequently entertained, lawyers who specialize in securities suits know that they have a better chance of winning if they allege aiding and abetting. For jurors, it is easier to believe that an auditor's, or lawyer's, or banker's failure to detect a fraudulent securities scheme "aided and abetted" that scheme than it is to believe that failure made the auditor a primary actor in the scheme.

Even the SEC, in an effort to compensate investor losses, has misjudged the reckless conduct standard. For instance, in a 1982 bankruptcy case the SEC charged the bankrupt company's accounting firm with reckless conduct. A Federal court totally rejected the claim, finding that it "involved complex issues of accounting as to which reasonable accountants could reach different conclusions. It follows that no finding of fraud or recklessness can rationally be made in that case."

Definitions of aiding and abetting, just as definitions of recklessness, do not make much difference. Definitions can be misapplied by juries. Holding a company to both a reckless and an aiding and abetting standard puts it at great risk before a jury, because both standards are so subjective. For this reason, the bill substitute amendment will not allow a reckless standard to be used in any aiding

and abetting case.

For the "knowingly" standard, the bill substitute will allow the SEC to prosecute for aiding and abetting but will not give private parties that right. Even limiting private parties to bringing actions that allege that companies knowingly aided and abetted in the commission of fraud will invite abusive litigation. The main costs involved in suits are discovery. For example, if a company audits a corporation, and in the course of that audit one memo is written that raises questions about that corporation's performance that is in disagreement with the final results of that audit, it may then be charged with "knowing" that the corporation would not perform well if in fact the value of the corporation's stock falls. In other words, the "knowingly" standard is also subject to abuse. Given this fact, Congress should not allow private suits to use this standard in conjunction with an allegation of aiding and abetting, which is a more subjective allegation than is an allegation that one has actually engaged in fraud. In all candor, we are even somewhat leery of letting the SEC prosecute for knowingly aiding and abetting.

The costs of settling or defending against any aiding and abetting action are prohibitive. Peat Marwick, for instance, spent $7 million in successfully defending itself against a charge that it aided and abetted a company in fraud through an audit it was hired for $15,000 to do of that company. Such frivolous, yet costly, suits have made it nearly impossible for smaller companies to even find accountants willing to audit them. No one benefits from the current system except those lawyers who have managed to develop it through case law. We are pleased that the Supreme Court has overturned that case law, and we are not about to reinstate it statutorily. Therefore, we urge the rejection of the Bryan amendment.